Section 3.4

**Activity 3.4.1**

1. Stakeholders that might be interested in Leroy’s accounts include:

* Banks and other creditors
* Employees
* Suppliers.

1. Leroy’s accounts might have been useful to the following stakeholders because:

* Banks and other creditors – repayment, risk of default, interest, need for new finance
* Employees – job security, wages, funds to improve working conditions
* Suppliers – repayment, risk of default, continued business.

1. a. Accounts can be prepared ethically by:

* Employing an auditor with an ethical reputation
* Ethical practices by management.

b. FlyNow’s accounts might have the following ethical issues:

* Sale of assets to boost cash flow and profits
* Cash from recent loan
* Over-valuation of airplanes
* Quality of work done on the airplanes increasing their value
* Delayed payments to creditors.

**Activity 3.4.2**

1. a. Cosy Corner Retailers profit statement:

|  |  |  |
| --- | --- | --- |
|  |  | $ |
| Sales | 1500 x $5 | 7500 |
| Cost of goods sold | 1500 x $2 | 3000 |
| Gross profit |  | 4500 |

b. Profit might be important for a business because it:

* Is a reward to the owners/shareholders
* Increases the value of the business if it is retained
* Shows how successful the business is.

1. Cambridge Boxes profit statement 2014:

|  |  |  |
| --- | --- | --- |
|  |  | $ |
| Sales | 3500 x $4 | 14000 |
| Cost of goods sold | 3500 x $2 | 7000 |
| Gross profit |  | 7000 |

**Activity 3.4.3**

1. Rodrigues Traders profit and loss account missing values:

* V = 8000
* W = 5000
* X = 4000
* Y = 3200
* Z = 2000

1. Three stakeholders that would be interested in the profit figures are:

* Banks and other creditors
* Employees
* Shareholders.

1. The reasons these stakeholders might be interested in these accounts could be:

* Banks and other creditors – repayment, risk of default, interest
* Employees – job security, wages, funds to improve working conditions
* Shareholders – profit and dividends, continued business.

**Activity 3.4.4**

1. Karachi Traders profit and loss account 1:

|  |  |
| --- | --- |
|  | **$** |
| Revenue (5000 units @ $4.00) | 20 000 |
| Cost of goods sold (5000@ $1.60 per unit) | 8000 |
| Gross profit | 12 000 |
| Overhead expenses | 5000 |
| Operating profit (profit before tax and interest) | 7000 |
| Finance costs (interest) | 1000 |
| Profit before tax | 6000 |
| Corporation tax @ 25% | 1500 |
| Profit for the year | 4500 |
| Dividends paid | 1200 |
| Retained profit | 3300 |

1. Karachi Traders profit and loss account 2:

|  |  |
| --- | --- |
|  | **$** |
| Revenue (6000 units @ $3.00) | 18 000 |
| Cost of goods sold (6000@ $0.90) per unit) | 5400 |
| Gross profit | 12600 |
| Overhead expenses | 4500 |
| Operating profit (profit before tax and interest) | 8100 |
| Finance costs (interest) | 2000 |
| Profit before tax | 6100 |
| Corporation tax @ 20% | 1220 |
| Profit for the year | 4880 |
| Dividends paid | 1200 |
| Retained profit | 3680 |

Activity 3.4.5

These items appear in these sections of the balance sheet:

* Company’s car – fixed asset
* Work in progress – current assets
* Four-year bank loan – long term liability
* Money owed to suppliers – current liabilities
* Issued share capital – shareholders’ funds
* Dividends owed to shareholders – current liabilities
* Value of patents – fixed assets
* Payments due from customers – current liabilities
* Retained earnings – shareholders’ funds
* Cash in bank – current assets.

Activity 3.4.6

1. The following balance sheet terms can be defined as:

* Trade receivables – the value of payments to be received from customers who have bought goods on credit
* Inventories – stocks held by the business in the form of materials, work in progress and finished goods
* Current assets – assets that are likely to be turned into cash before the next balance sheet date
* Shareholders’ equity – the value of shares issued to shareholders plus accumulated retained profit.

1. Mauritius Telecom’s balance sheet in 2012 and 2013 tells us its position has changed in the following ways. The value of:

* Fixed assets has fallen
* Stock has fallen
* Debtors has increased
* Cash has increased
* Total asset has increased
* Long-term liabilities has increased
* Current liabilities has fallen
* Shareholders’ equity has increased.

1. a. Accounting information might be useful to a potential investor because it provides information about:

* Potential profits
* Cash flow and debt
* Value of the business and parts of the business.

b. Accounting information might be useful to creditors because it provides information about:

* Potential repayment
* Cash flow and debt
* Value of assets for securing loans.

Activity 3.4.7

1. ‘Depreciation’ is the decline in the estimated value of a fixed asset over time. Assets are items of monetary value that are owned by a business.
2. Straight-line depreciation of the new lathe is: ($3 000 000 - $200,000) / 10 = $280 000.
3. Declining balance depreciation of the new lathe is:

* Year 1 3 000 000 x 0.12 = $360 000
* Year 2 2 640 000 x 0.12 = $316 000

1. The advantages to Hardy Engineering of using declining balance depreciation might be:

* More accurate reflection of the way assets depreciate
* It allows for changes in technology and asset obsolescence
* Better matching of the cost of an asset with the revenues of an asset when it is new.

The disadvantages are:

* It is based on forecasted residual value and useful life
* It is more difficult to calculate than straight-line depreciation.

Exam practice question

1. Advantages that large supermarket chains might have over Carlos’s shop might be:

* Buying food in bulk at lower unit costs
* Brand recognition
* Large-scale capital reduces unit costs.

1. a. Carlos’s profit and loss account for 2010:

|  |  |  |
| --- | --- | --- |
|  |  | $ |
| Sales | 80 000 x 12 | 960 000 |
| Cost of goods sold | 960 000 x 0.75 | 720 000 |
| Gross profit |  | 240 000 |
| Indirect cost |  | 20 000 |
| Net profits |  | 220 000 |

b. Annual depreciation expense of the van is: ($40 000 - $8 000) / 4 = $8 000

c. The usefulness of Carlos’s profit and loss account to different stakeholders might be:

* Banks and other creditors – repayment, risk of default, interest
* Employees – Job security, wages, funds to improve working conditions
* Shareholders – profit and dividends, continued business.

Key concept question

Ethics might be important in producing a set of accounts in terms of fair and accurate view of a business’s:

* Profits and asset value for shareholders
* Cash flow and asset value for lenders and creditors
* Cash flow and profits for employees
* Profits for the government
* Profits and asset value for potential investors
* Cash flow and asset value for suppliers
* Profits, cash flow and asset value for the local community.

Without an ethically produced set of accounts, stakeholders may be misled on the business’s financial position and may make the wrong decisions because of this.